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# Islamic finance in Russia: A market review and the legal environment

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## 1. Introduction

The objective of the article is to study the developments of the Islamic finance market in Russia, with regard to its regulation and main hurdles, infrastructure development, geographical reach, existing market players and its product range, market volume and forecast, and new initiatives.

As a country from east to west, Russia, throughout its history, has been a mixture of cultures and a place where trade routes cross. Russia's native Muslim population is usually assessed at 15–25 million by various estimates (10–17% of the total population).<sup>1</sup> There is historic evidence, that Russian Muslim scholars were among the first at the beginning of the 20th century to develop the concept of an Islamic bank (Hajjar & Habib, 2019; Zaripov, 2018).

In the 1990s, there were the first attempts to justify and support the creation of Islamic banks in Russia. This process in former USSR countries is regarded as a natural attribute of religious awakening (Hoggarth, 2016). The first and only bank which positioned itself as an institution following Islamic finance technologies, Badr Forte Bank, with a limited range of products, operated from 1996 to 2006. It was only in the 2010s when several Islamic finance projects were created in various Russian regions, some of which still exist, and their experience allows us to assess some results. Starting from 2014, when the western capital market was restricted for Russia, the Russian authorities along with some big banks and corporates, for the first time, set their sights on Islamic banking as an alternative. The developing relations, at a high political level, between Russia and the Gulf countries, opened new opportunities for economic cooperation, including the Islamic finance segment. Effective cooperation in investment with foreign companies and funds also depends on the development and maturity of the local Islamic finance market, including relevant business projects.

The sanctions, imposed on Russia, have limited the range of financial resources that Russian organizations can attract from the international market. The local sector, specifically, small and medium enterprises, are lacking financial resources to expand their businesses. Islamic finance instruments, based on trade finance and risk sharing mechanisms, are a sound alternative for businesses independently of their religious views. For retail customers, trade-based financing of their needs is also a solution.

The remaining part of the paper is organized as follows. Section 2 includes a literature review on Islamic finance in Russia. Section 3 explains the author's methodology in conducting the research. Section 4 is devoted to the analysis of the Islamic finance market in Russia in the following order: Section 4.1 analyses institutions rendering Islamic finance services in Russia, throughout 2010–2019, dividing all of them into six major groups, by type of business; Section 4.2 presents market dynamics and statistics; Section 4.3. covers

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<sup>1</sup> By now, there is no generally accepted data on the number of Muslims in Russia due to the absence of a question on religion in the official census. The main figures are usually based on the number of nationalities historically practicing Islam. In 2003, in his address speech in the Organization of the Islamic Cooperation Summit, Vladimir Putin stated that the number of Muslims in Russia is 20 million. Indirect evidence for this number is the hajj quota, which is calculated as around 0.1% of a country's Muslim population (see also Kingdom of Saudi Arabia General Authority for Statistics (URL: <https://www.stats.gov.sa>). In 2020, initially, before the pandemic was announced, Russia's quota for hajj was 25,000. Aleshin and Radchenko (2018) indicate that the number of Muslims in Russia is not below 30 million. They also cite Govorukhin, a member of the Russian Parliament, whose estimates are 35–37 million people (25% of the population).

the regulatory framework for the market; [Section 4.4](#) sums up the available Islamic finance products by type and geographical reach; in [Section 4.5](#) the main legal and taxation impediments are analyzed; [Section 4.6](#) provides a brief overview of the sukuk market prospects; a note on Shariah background is given in [Section 4.7](#); finally, [Section 4.8](#) sums up with a forecast. [Section 5](#) provides some final remarks.

## 2. Literature review

Until recently, the various aspects related to the development of the Islamic finance market in Russia had not been researched except for some limited observations of the overall Islamic finance market in the CIS regions (Kalimullina, 2009; and others), and a few polls conducted among potential Islamic finance service consumers (see for example Kalimullina, 2010). Starting in 2015, there was an increase in the number of papers devoted to Islamic finance in Russia. Web of Science database includes four papers addressing the topic of the Islamic finance market in Russia and its prospects (Chokaev, 2015; Hazzar, Alekseeva, & Mikheeva, 2018; Ivanova, Sokolov, & Sokolova, 2018; Malyaev, 2017). Chokaev (2015) analyzes the main impediments for the development of Islamic finance institutions in Russia and specifies the potential economic benefit. Hazzar et al. (2018) address the Islamic banking regulation system, comparing the Shariah approach and Russian legislation, and suggesting a phased approach to creating a proper legal environment. The main focus of previous research was the analysis of the legal environment and challenges to Islamic finance development (Hazzar et al., 2018; Chokaev, 2015), the study of the prospects for the Islamic insurance market (Bekkin, 2007; Magomadova, Khominich, & Savvina, 2018), overview of certain Islamic finance transactions (Musaev & Magomedova, 2018) and agreements, particularly, *ijarah* (Ivanova et al., 2018), along with the general significance of the Islamic finance industry for Russia (Zaripov, 2016; Yordanova, 2018; Malyaev, 2017). A relatively detailed market review was performed by Juravliov (2013a), but it was published in a non-academic source.

Several other studies, in Russian, are devoted to the development of Islamic finance in Russia. Among them are the research papers by Bekkin and Aliskerov (2017) on the specifics of the Islamic finance sector in Russia; Aleshin and Radchenko (2018) on the barriers of Islamic finance adaptation in Russia; some studies on the regional aspects of Islamic finance development in the republics of Tatarstan, Dagestan and Chechnya (Rashidov & Danchenko, 2017; Saraliev & Tashtamirov, 2015; Taimaskhanov, Musaev, & Reshiev, 2015); and research by Musaev and Magomedova (2018) on the experience of the implementation of Islamic finance instruments in Russia. Some articles by Kalimullina (2017, 2018) are devoted to the issues on the standardization of the Islamic finance operations in Russia and the potential directions of Islamic finance market development in Russia.

## 3. Materials and methods (methodology)

The paper includes a study of the legal documents and data of the authorities and Islamic finance institutions, as well as publications from the Islamic finance expert community in Russia. Being actively involved in Islamic finance industry-related discussions and events in Russia, the author contributes by her own opinion and observations.

Since the Islamic finance sector is currently unregulated in Russia, there is no official register or a list of Islamic finance companies or Islamic finance projects and transactions. To form a list of such companies, the author's own experience and knowledge of the market were used. The list of Islamic finance companies and products presented is formed based on the availability of Shariah control, which is an international practice based on AAOIFI standards. This being said, the author does not exclude from the list the projects and companies, the level of Shariah control of which is questioned by some industry experts, given the fact that such projects have a significant level of political or international support or general market acceptance. The projects, which were announced, but failed to start their operations or had not received public acceptance, are not included in the list (see footnote C to [Table 1](#)).

The article does not study bilateral Islamic finance deals, such as *tawarruq* operations, as well as direct investment deals with the involvement of the Islamic capital (direct investment from the Islamic world). Therefore, the figures provided in [Fig. 5](#) assessing the market size do not include these data.

An anonymous survey (a poll) was conducted among the Islamic finance market players in Russia. In total, 12 companies took part in the poll. The poll data input form is submitted in the attachment.

Among the hypotheses of the poll are the following:

- 1) Islamic finance companies provide mainly *murabaha* financing;
- 2) Geographically, Islamic finance products are mainly available in three regions: Tatarstan, Dagestan, and Chechnya;
- 3) The Russian Islamic finance market lacks proper regulation;
- 4) A tax-friendly regime for Islamic finance operations is required to create a level playing field;
- 5) Involvement of Islamic finance operators in the programs of state subsidy is a matter of high importance;
- 6) A self-regulatory organization could be a sound solution for the market.

The main figures are cited in Russian rubles, and quoted in USD. The exchange rate used by the author is 63.7864 RUR per 1 USD, which is the average exchange rate throughout the period 2017–2019. It should be noted that in 2014 the exchange rate doubled ([Fig. A](#)), that has an impact on the Islamic finance market performance and size.

The exchange rate volatility started in March 2020 caused by coronavirus and oil price drop-down and its influence on the research figures are not reflected in this paper.

**Table 1**  
Islamic finance institutions and projects in Russia, 2010–2019.<sup>c</sup>  
Source: the author; the poll results & interviews conducted.

Type	Name of the institution/project	Year of creation	Year of closing	Reason of closing/transformation (if any)	Region	Range and type of products
Microfinance <sup>a</sup>	Yumart Finance	2010	2011	Assets had been acquired by Amal FH	Tatarstan	Mudaraba, Murabaha
	Amal Finance House	2010 (public opening in 2011)	–	–	Tatarstan and other Russian regions <sup>b</sup>	Mudaraba investment, Murabaha, Mudaraba financing
	LaRiba Finance	2011	–	–	Dagestan	Ijarah financing, Salam financing, Istisna' financing, Mudaraba investment, Murabaha, musharaka financing
Banks	Fincity Bank Express	2017	–	–	Chechnya	Murabaha financing
	AF Bank	2010	2011	Bank's internal decision	Dagestan	Payment Card
	Vostok Capital ("Islamic window" of Ellipse Bank)	2015	2012	Withdrawal of a license from the bank	Bashkortostan	Murabaha (Hayat) Card <sup>d</sup>
	Moscow Industrial bank	2015	2014	Withdrawal of a license from the parent bank	Nizhni Novgorod, Bashkortostan, and Saratov	Payment Card
	Centre for partnership banking (Tatagroprombank)	2016	2019	Reorganization of the bank by the Central Bank of Russia	All Russian regions	Current accounts, ijarah financing
	Sberbank	2016	2017	Liquidity issues as a result of the withdrawal of a license from the parent bank	Tatarstan	Payment card for the pilgrims
	Sovcombank	2017	–	–	Russian and international markets	Mudaraba investment, Murabaha, Mudaraba Financing, Mudaraba financing, murabaha financing
Investment companies	AK BARS Bank (branch)	2019	2019	Bank's internal decision	Tatarstan, Bashkortostan and some other regions	A banking credit card based on qard hasan concept
	Tatarstan International Investment Company (TIIC)	2010	–	The company presently has no active operations	Tatarstan	Mortgage finance
	Zayed Fund for entrepreneurship and innovation, LLC	2017	–	–	Chechnya	Mudaraba, ijarah financing
Asset managers	BCS	2007	2015	Company's internal decision	All Russia	Mudaraba and musharaka financing
	AK BARS Capital	2019	–	–	All Russian regions	Asset management (mutual funds) based on mudaraba agreement
Mortgage finance	Zhilishchnye Traditsii (housing savings cooperative)	2018	–	–	Tatarstan, Bashkortostan, Saint Petersburg	Asset management (mutual funds) based on mudaraba agreement
						Mortgage finance (based on diminishing musharaka scheme)

(continued on next page)

Table 1 (continued)

Type	Name of the institution/project	Year of creation	Year of closing	Reason of closing/transformation (if any)	Region	Range and type of products
Other	Eurasian leasing company	2012	–	–	Tatarstan and other regions of the Volga Federal District, Moscow, Saint Petersburg	Leasing ( <i>ijarah</i> financing)
	Microcredit Company <i>Barakat</i>	2012	–	–	Chechnya and other regions of the North Caucasus	<i>Murabaha</i> , interest-free loans ( <i>qard hasan</i> )
	Euro-Policy Insurance company	2012	2014	Owners' internal decision	Tatarstan, Bashkortostan and Nizhni Novgorod	Overseas travel insurance & other products

<sup>a</sup> It should be noted that a microfinance company mentioned in this article does not directly reflect the form of any microcredit or microfinance organizations as per the Russian Civil Code. Starting from 2017, a number of institutions commenced their operations in various Russian regions, specifically the republics of the North Caucasus, taking as an example the first-comers' models of work in providing Islamic finance services. Today their number exceeds 15, and they mainly work in the form of limited partnerships with a limited range of operations.

<sup>b</sup> A wider range of operations is rendered in Tatarstan, whereas attracting investment and limited financing opportunities are available in Moscow, Moscow region, and some other regions of Russia. In some regions, there is a system of agents acting as representatives.

<sup>c</sup> The Table provides a list of institutions rendering Islamic finance products and services regularly. Cases of one-time deals, such as tawarruq transactions, are not mentioned in the Table. The list also comprises only those institutions which claim Shariah compliance of their operations (products) and are generally acknowledged by the public. Projects that were announced but not started are also not included in the Table. Some Islamic finance companies, although providing data for the research, wished not to be mentioned in the article.

<sup>d</sup> For more details on the underlying mechanisms of the bank's payment card and murabaha card see Juravliov (2013b).

## 4. Analysis

### 4.1. Russian institutions rendering Islamic finance services

#### 4.1.1. General market overview and statistics

Islamic finance institutions and projects in Russia have mainly been founded starting from the year 2011 (Table 1). Although not all of them still exist, the experience of each has contributed to the general market development. Apart from 20 projects included in the Table, there are about 10–15 projects of a smaller scale and popularity. Although not mentioned in the Table and the text, when analyzing the market size, the author takes into account some data available or obtained via the poll or personal anonymous interviews.

All institutions can be roughly divided into six main groups: non-banking microfinance institutions, banking institutions, investment companies, asset management companies, mortgage finance cooperatives, and others (leasing, microcredit, and insurance companies). The first group is mainly represented by fully-fledged Islamic finance companies; the second group are banks which are implementing Islamic finance products either through a separate branch ("Islamic window") or without the creation of such by the introduction of pilot financial products; the third group entities are mainly organized in the form of an investment company; the fourth group are conventional asset managers who established a separate Shariah-compliant mutual investment fund. The fifth group is represented by a cooperative, providing services on Islamic mortgage finance, representing a promising market in Russia. The sixth group unites other forms of institutions that are not included in the first five (Table 1). The author provides a description of each group in the subsections below.

The number of employees of Islamic finance companies and projects today accounts for about 150 specialists at least. The total number of clients is estimated by the author at about 40,000. The projects which are not active nowadays had another 25 thousand clients at the highest estimate.<sup>2</sup>

#### 4.1.2. Islamic microfinance companies

Among Islamic microfinance companies, the most well-known and biggest, from an asset point of view, are Amal Finance House and LaRiba Finance Company. They are organized as limited partnerships (trust partnership, consumer society) but the business models are different. Dagestani LaRiba Finance specializes mainly in retail short-term *murabaha* financing: the maximum finance period is 12 months and the maximum amount is 500,000 RUR / 7838.66 USD (Lariba-Finance, 2019). Amal Finance House is concentrating mainly on business financing (Fig. 1a), with the maximum sum being 40 million RUR / 627,093 USD, and the maximum term is 36 months (AmalFH, 2019). Yet, in 2019, Amal also announced short-term retail financing under the *Iqra* program. On the funding side, LaRiba follows the strategy of working with a limited range of investors, which is explained by two main factors: the legal form implemented (the trust partnership form only allows up to 20 participants) and the mentality of the local people. The latter implies the impracticability of written agreements in many cases when investors decide to withdraw their amounts. Being a supplier of financial services, the company is heavily dependent on the stability of funds. Amal, on the contrary, attracts investors from all Russian regions, based on *mudabara* investment agreements, and tries to expand its investor base by constantly updating the investment schemes and mechanisms. The mentioned companies were the main "drivers of the industry" (as indicated by Juravliov, 2013b) starting from 2011, and encouraged others to come up with similar initiatives.

The LaRiba Finance company website provides a detailed catalogue of goods that can be acquired through the company: electronics and housing equipment, furniture, equipment for cafes, bicycles, training facilities, goods and equipment for kids, photo and video equipment, cooling machinery, and vending equipment. The company also provides car financing.

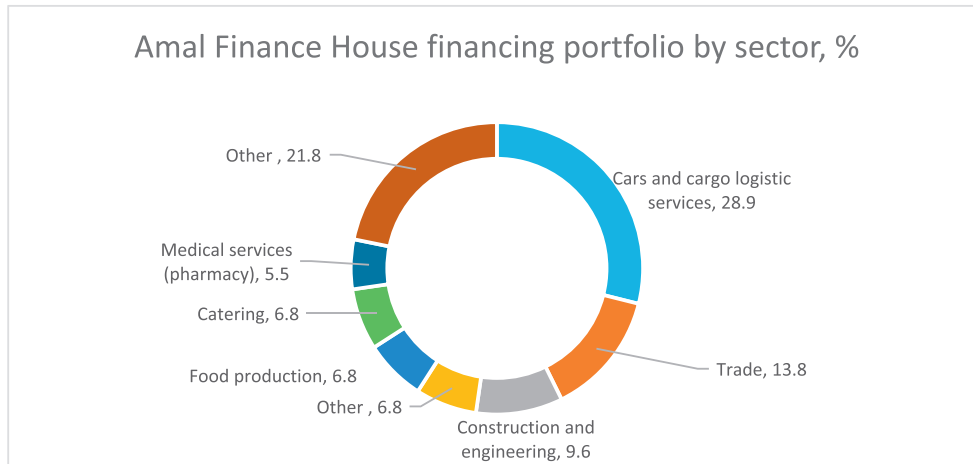
#### 4.1.3. Banks with Islamic finance products

While microfinance companies demonstrate higher stability in the market, the banks which have been involved in Islamic finance projects, although having larger initial funds, appeared to be less stable. From among 8 banks that entered the Islamic finance market with their products, only two are still rendering Islamic finance services, in 2019 (Table 1). The main reason is not related to Islamic finance though. In 2016, the Central Bank of Russia withdrew the licenses and imposed a reorganization procedure over three of them, including Tatagroprombank, which initiated the "Islamic window", the subsidiary bank of Tatfondbank. The bank's Islamic finance project, Centre for Partnership Banking, was positioned as a pilot Islamic banking project of the Republic of Tatarstan, and its discontinuance was sadly received by the regional and expert community. The two other banks, Sovcombank and Express bank, put on hold Islamic finance pilot products at their discretion.

Despite its short time of existence, the Ufa branch of Vostok Capital, the Islamic branch of Ellipse Bank, implemented several Islamic finance products: current accounts (*qard hasan*) and *ijarah*-based financing. Its client base exceeded 250 clients, including 50 recipients of financing.

Tatfondbank assets, in 2017, equaled 214 billion RUR / about 3.355 billion USD. Sberbank which entered the Islamic finance market in 2016, has 29.1 trillion RUR of assets (about 456 billion USD) (Table 3). According to the bank's website, there are 95.4 million active retail clients in Russia and 2.5 million clients among enterprises. The bank has 14,200 branches in Russia (Sberbank, 2019c). Sberbank's entry into the market, given its allocated financial portfolio, has led the market to its growth, twofold in 2018 (Fig. 5). The bank's first deal was a *mudaraba*-based transaction for a Tatarstan-based leasing company for the amount of 45 million

<sup>2</sup> The assessment is done by the author based on the poll results, data provided during the personal interviews, and the author's expertise.



**Fig. 1a.** Amal Finance House financing portfolio by sector, 2011–2018, %.

Source: Amal Finance House (Sagdeev, 2019).

**Table 3**

Major Russian banks rendering Islamic finance products (including suspended) by asset size, bln RUR, 2019.

Source: banki.ru, 2019.

Rating (among Russian banks)	Name	Assets size, November 2019, bln RUR	Assets size in USD, bln	Status
1	Sberbank of Russia	29,148.9	456.98	Active
13	Sovcombank	1146.8	17.98	Active
17	Ak Bars Bank	611	9.58	Active
26	Moscow Industrial Bank	429. 4	6.7	Under the reorganization of the Central bank
–	Tatfondbank, (the parent bank of Tatagroprombank) 2016	214.2	3.36	License is withdrawn in 2016

RUR / 705,480 USD. There are also some indications (Bekkin & Aliskerov, 2017) that certain Islamic finance services had been provided by the Moscow branch of Azerbaijani MBA-bank. However, due to the lack of data, this initiative is not included in the current research.

Sberbank, the biggest Russian bank by assets, announced in 2019 that its Islamic finance portfolio had reached 16 billion RUR / 250 million USD. This sum included the ICR deal in Turkmenistan for 14 billion RUR / 219.5 million USD, in April 2019. The bank mainly concentrates on export trade finance (mostly, grain), which accounts for about 98% of its Islamic finance operations. There is no open data, however, on the specifics of the bank's Islamic finance deals and its legal or Shariah structure. Sberbank is positioning itself not merely as a bank, but as a dynamically developing financial ecosystem. Its products are popular both among companies and retail customers. The bank provides limited information on its Islamic finance operations, targeting its potential audience mainly through specialized events and media. Sberbank's plan on Islamic finance has changed since the inception of the project. In 2017, Sberbank planned to create a special Islamic finance entity and propose regulatory changes (Vizcaino, 2017). However, in two years, the plans did not come to fruition, although the bank's Islamic finance portfolio had been growing yearly. The bank positions its presence in the Islamic finance market in the following directions:

- 1) providing Sharia-compliant finance for businesses based on project finance (*mudaraba*);
- 2) export financing of grain and other products to countries of the Middle East;
- 3) *wakala murabaha* deals in cooperation with international institutions;
- 4) socially responsible business and fintech.

Among Sberbank's big deals performed in cooperation with IDB is a deal for Turkmenistan amounting to 219.5 million USD in favor of Chelyabinsk Pipe Plant (part of the Chelpipe group) as part of the construction project for a section of the TAPI gas pipeline. According to its website, the bank acted as the confirming bank for the export letter of credit issued by the State Bank for Foreign Economic Affairs of Turkmenistan, under the irrevocable commitment for reimbursement of IDB (Sberbank, 2019a).

In 2019, Sberbank acquired a share in Payzakat, a Russian IT startup project aimed at raising funds for charities in various regions of Russia.

In 2019, during the 2nd Russian Islamic Economic Forum in Ufa, Sberbank launched its accelerator for projects correlated with Islamic banking. Sberbank claimed that the Russian businesses need Islamic based financing amounting to 8.5–9 billion RUR annually



(up to 141 million USD) (Sberbank, 2019b). According to Sberbank's first vice-chairman Oleg Ganeev, the bank considers Islamic finance as "a separate business model with a separate customer segment" and "a unique product line, and its proprietary risk management system aligned with the values of Islamic ethics". Sberbank was preparing to "launch products and services of partner finance across Russian regions, both for corporate and retail clients", which "would drive regions with a high density of Muslim residents and would enhance the investment attractiveness of these regions" (Sberbank, 2019b).

Having subsidiaries in some CIS countries, Sberbank has set plans to expand to the Gulf regions and stated its interest to establish an office in the region to the media.

#### 4.1.4. Investment companies

There are two investment companies dedicated to Islamic project finance in Russia – TIIC and Zayed Fund (Table 1). Both projects were created with the help of foreign investors. TIIC was created in 2010 with the participation of the Jeddah based Islamic Development Bank, the Government of Tatarstan, and five financial institutions from the Gulf region. Zayed Fund was established by the UAE-based Khalifa Fund for Enterprise Development (UAE), in 2017. To some extent, both companies were created as an exception from the rules. Normally, the IDB Group does not establish projects in non-member countries.<sup>3</sup> Khalifa Fund was initially created for operations only on the territory of the UAE. The results of the two are different. TIIC with its capital of 90 million RUR<sup>4</sup> has only established the Eurasian Leasing Company in 2012 (Table 1) and could not expand its financing operations further, due to some internal policy limitations. As outlined by Yakupov, advisor to Tatarstan's prime minister for cooperation with Islamic financial institutions, among other factors that impeded the company's development, were challenges to projects' [legal] structuring and the financial crisis of 2008–2010.<sup>5</sup>

Zayed Fund, at the time of its creation, got the undertaking from the investors for 50 million USD to be directed to the Fund's programs. In 10 years' time, the Fund plans to finance projects "worth more than 300 million USD" (ZayedFund, 2019). The Fund operates only on the territory of the Chechen Republic, and in its financing activities, pursues policies to support human capital development: generating employment and promotion of entrepreneurship. According to the words of Nizar Cheniour, the fund doesn't invest in a business, it "invests in humans" (MuslimEco, 2019a).

Zayed Fund still has conventional finance in its portfolio, which is, according to the fund's representatives, kept for the sake of financial inclusion of all potential clients wishing to partner with the fund. However, its share is insignificant. Out of all contracts concluded, 97% is based on Islamic finance principles. From among approved projects which have not been launched yet, the share of Islamic finance is expected to be even higher (Arsae, 2019). Such statistics are quite predictable: in Chechnya, the Islamic traditions are strong, and Shariah norms and principles are highly integrated into the daily life of people, including their way of doing business. The finance limit per each project is 1 million USD; the maximum term of financing is 4 years. By October 21, 2019, the Fund had provided financing amounting to 380 million RUR/ 5.96 million USD to 96 projects, which were selected from over 1144 business projects and ideas. The fund's programs created 250 new jobs. Additional 65 projects amounting to 343 million RUR / 5.38 million USD were also approved for financing (Table 2a).

The main recipients of Zayed Fund's financing by the economic sector are food and drink production, wholesale and retail trade, and farming (including animal and crop farming) (Fig. 1b), which is in line with the fund's financing policy. The organization does not finance projects related to rendering finance services, consultancy, marketing, and publishing activities, and does not provide personal loans.

Zayed Fund's main financing contracts are *musharaka* and *murabaha*. The effective margin in *murabaha* is 6% of the asset cost. *Murabaha*-based financing accounts for about 82% of all the portfolio, whereas *musharaka* contracts are relevant in 15% of deals (Fig. 1c).

It should be mentioned that the Russian Direct Investment Fund (RDIF) has been actively cooperating with Gulf investors, and has an allocated portfolio to project financing (RDIF, 2019), yet there is no Islamic finance specified portfolio so far.<sup>6</sup>

#### 4.1.5. Islamic mutual investment funds

The Islamic finance asset management project, in the form of a mutual investment fund, was first initiated by a big Russian asset management company, BCS. The company, with the assistance of Shariah experts, developed a mutual investment fund under the name *Halal MIF*. The list of approved stocks was formed every month. The main challenge was the time of its start: it was launched just several months before the financial crisis of 2008.

Although it reached the initial net asset value in 2010, and the highest value was at the beginning of 2011 (Fig. 2a), the company

<sup>3</sup> In 2005, Russia gained the observer status in the Organization of the Islamic Conference. Prior to that, in 2003, Russia's President Vladimir Putin addressed OIC general assembly with a remarkable speech: "I am certain that Russia's participation will not only add to the rich spectrum of the Organisation, it will also bring new possibilities to its work, and add the weight and voice of the large Russian Muslim community. A community which no longer separates itself from the international community of Muslims, and which is prepared for productive involvement in its spiritual, cultural and political life." (URL: <http://en.kremlin.ru/events/president/transcripts/22160>)

<sup>4</sup> At the time of inception, the sum amounted to 3 million USD.

<sup>5</sup> Sarimova, L. "Proekt okazalsya neudachnym": Kak umirala Tatarstanskaya Mezhdunarodnaya investitsionnaya kompaniya. ("The Project appeared to be unfortunate": How the Tatarstan International Investment Company Deceased). / Realnoe Vremya. March 26, 2020. URL: <https://realnoevremya.ru/articles/169835-eksperty-o-smerti-tmik-i-prichinah-provala-proekta> . Access date: March 29, 2020.

<sup>6</sup> It should be noted, however, that investment coming from the Gulf still have certain limit pertaining to the spheres of investment: such fund cannot be directed into activities prohibited by the Shariah.

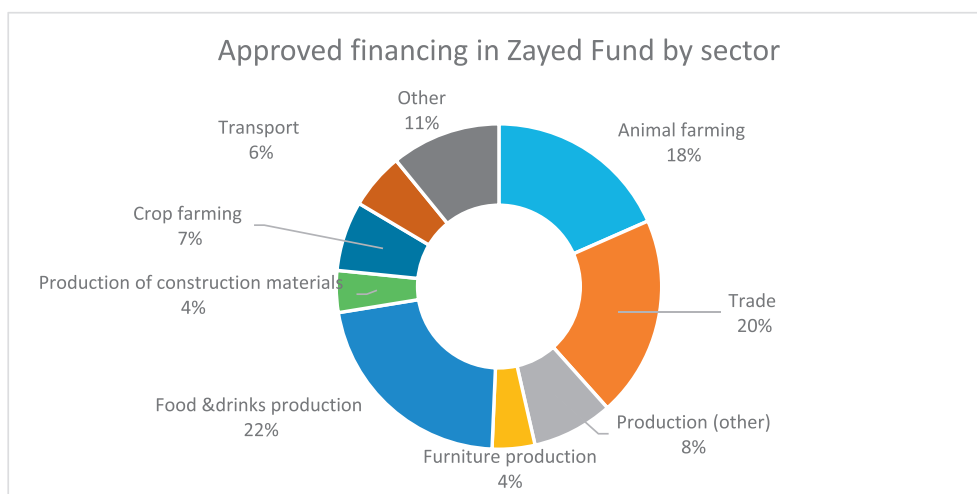


**Table 2a**

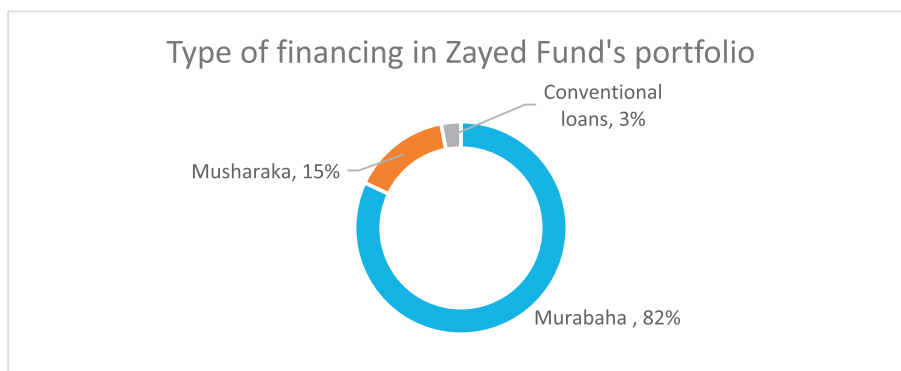
Zayed Fund's approved financing by economic sectors, 2017–2019, RUR.

Source: Zayed Fund (Arsaev, 2019).

Economic sector	Number of projects	The approved amount of financing, RUR	The approved amount of financing, % of total
Tourism and hospitality	3	14,500,000	2.0%
Animal farming	36	133,214,277	18.4%
IT	1	2,300,000	0.3%
Cafes, restaurants, and food delivery	4	7,755,808	1.1%
Distribution trade	26	113,293,409	15.7%
Production (other)	11	58,212,168	8.0%
Furniture production	5	30,719,420	4.2%
Production of drinks	4	15,935,000	2.2%
Food production	15	141,498,551	19.6%
Production of construction materials	7	30,078,150	4.2%
Crop farming	12	50,256,444	6.9%
Retail trade	8	31,360,332	4.3%
The auto workshop, car wash	2	6,080,000	0.8%
Construction services	5	21,669,550	3.0%
Transport	11	40,420,000	5.6%
Services (other)	5	12,620,330	1.7%
Medical services	6	13,849,960	1.9%
Total	161	723,763,398	

**Fig. 1b.** Approved financing in Zayed Fund by sector, RUR.

Source: the author based on Zayed Fund's data (Arsaev, 2019).

**Fig. 1c.** Zayed Fund portfolio by the type of financing, 2017–2019.

Source: Zayed Fund (Arsaev, 2019).

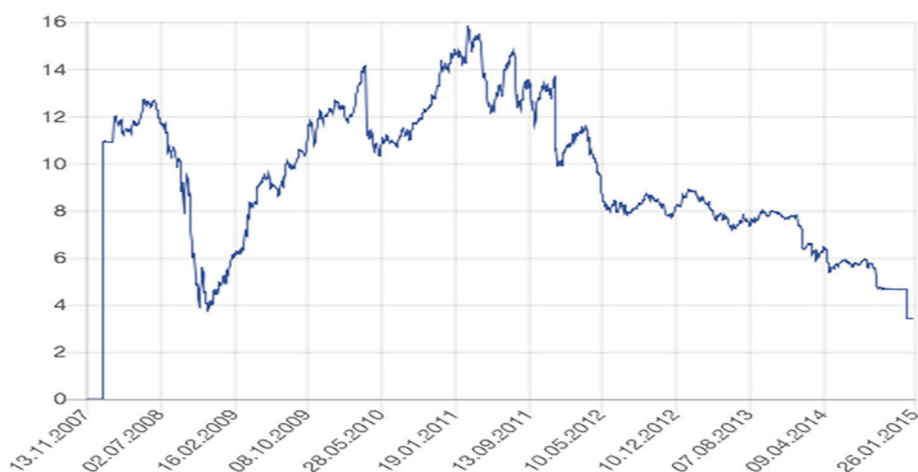


Fig. 2a. Net assets value of Halal MIF, BCS.

Source: NAUFOR, 2019.



Fig. 2b. The unit value of Lale MIF, AK BARS Capital.

Source: AK BARS Capital, 2019.

decided to close the project towards the end of 2014.

In 2019, Ak Bars Capital, the asset management arm of Ak Bars Group, announced the start of an Islamic mutual investment fund, under the name *Lale*. The company does not disclose fund methodology. Initially, 48 companies from the Russian market had been selected based on the internal criteria, and 16 companies' stocks (blue chips) formed the fund (Haliullin, 2019). In the last three months, the net asset value of the fund has grown by 35.48%. As per December 24th, 2019, the NAV of the fund equaled 13.6 million RUR / 213 thousand USD. The unit value grew by 9.61% (Fig. 2b).<sup>7</sup> Some other Russian asset management companies provide their clients services of Islamic investment into Shariah-compliant stocks on the international market. For example, *Finam* company developed a strategy for stock investment in the US market. The strategy is based on the stocks which comply to the Shariah screening methodology (such as adopted by Thomson Reuters and MSCI). *Finam* suggest its own algorithm of Islamic stocks selection for portfolio, as described on the company's website.<sup>8</sup>

#### 4.1.6. Mortgage finance cooperatives with Islamic products

The first mortgage finance cooperative in the current Islamic finance market was created in 2018, reflecting the general demand of the Russian population in home financing. The increase in demand is caused by the reforms related to construction co-funding in Russia. In 2018, amendments were introduced into Federal Law 214-FZ, on apartment block construction co-funding. Starting from July 1, 2019, all construction companies must use funding mechanisms based on escrow accounts (Fig. 3). This implies that funds cannot be taken from the clients and directed to construction needs. Instead, the funds must be reserved on the accounts, and bank

<sup>7</sup> In March 2020, in the framework of the general financial markets decline, the fund unit value dropped.

<sup>8</sup> Investitsii dlya musulman (Investment for Muslims). *Finam*. URL: <https://www.finam.ru/landings/usa-islamic-market/>



Fig. 3. The number of active agreements for construction co-funding.

Source: State National Project “Housing and City Environment” (National Projects Infographics, 2018).

credit should be used, which is against the Shariah norms. This development left the cooperative model as the most optimal option for home financing.

In less than 2 years (2018 and 2019), the Housing Cooperative *Zhilishchnye Traditsii* (Housing Traditions), which financed apartments constructed by a Yunstroy company of a premium segment, raised funding amounting to 838 million RUR / 13.138 million USD, exclusively (Batyrsin, 2019) for *musharaka*-based financing (the cooperative also provides financing on the conventional basis). In total, 313 apartments were bought through the organization by December 2019 (znkg.ru, 2019).

Apart from the cooperative *Zhilishchnye Traditsii*, there are some other initiatives being actively discussed within the expert and business community of Russia.

The start of *Zhilishchnye Traditsii* contributed to further increase in Islamic finance assets of the Russian market (Fig. 5).

#### 4.1.7. Other Islamic finance projects and products

The Eurasian Leasing Company (ELC) was established by TIIC. The technical partner of TIIC over this project was the Ijara Management Company (Bahrain), the subsidiary company of the Islamic Corporation for the Development of the Private Sector (ICD). ELC is providing leasing services for the companies to acquire the following types of assets: cars, building machinery, production machinery, medical equipment, and telecommunication equipment (ELC, 2019a). On its website, the company states that its philosophy is to provide the clients with a special type of leasing which is *ijarah*-based leasing (ELC, 2019b).

Microcredit company *Barakat* is established in a legal form regulated by a law on microfinance activities and microfinance companies and is subject to regulation by the Central Bank. In practice, the company specializes in interest-free financing (*qard hasan*) and *murabaha* financing. The clients are charged with fees treated as interest by law, but regarded as a symbolic fee, necessary to cover some direct expenses related to the company's operations.<sup>9</sup> Between 2017 and 2019, the company became the winner of the Central Bank's contest for the best social projects among microfinance institutions (RMC, 2019).

Euro-Policy Insurance company initiated Islamic insurance products in 2012. It was mainly transport insurance, overseas travel insurance, and property insurance products. The attracted funds were placed on current accounts of the Islamic branches of Ellipse Bank and Bulgar Bank<sup>10</sup> as the only Shariah-compliant alternatives available. The scheme involved a waqf fund with the insurer's undertaking to cover the gap in case liabilities exceed the fund amount. Such an undertaking would be executed on the principle of *qard hasan* (Juravliov, 2013b).

#### 4.2. Islamic finance market size and dynamics

Despite the lack of regulation and cases of reorganization of several banks which had initiated Islamic finance services, the overall number of active Islamic finance initiatives has been growing year on year basis (Fig. 4). The distinctive feature of Islamic microfinance companies is its subject to the general Civil Code regulation. Organized in the form of non-licensed trustees or limited partnerships, they are not supervised by the Central bank. They are also not subject to public accountability. Therefore, the data provided in Fig. 5 is based on the author's market analysis, a combination of published reports, the data provided by the companies and projects, and the evaluation of a variety of factors such as media announcements, one deal limits, etc. Fig. 5 combines the author's evaluation of assets of Islamic finance institutions and projects, including the 20 mentioned in Table 1.

Apart from the year 2015, when the Islamic finance market declined by asset size (due to the currency crisis), the market generally saw a steady growth between 2010 and 2019. Starting from about 200 million RUR (about 6 million USD at that time<sup>11</sup>),

<sup>9</sup> The issue related to the permissibility of a fee in a loan is questioned by some Islamic scholars. AAOIFI Standard No. 19 allows the creditor to take from the borrower an amount limited to direct expenses stemming from the loan (AAOIFI, 2004).

<sup>10</sup> Bulgar Bank was a relatively small regional bank which organized a separate branch for the operations of Amal Finance House. But the bank's licence was withdrawn in 2017, and Amal started being serviced by Sberbank.

<sup>11</sup> Juravliov (2013) evaluated the Islamic finance market turnover in Russia at about 6 million USD.



Fig. 4. Russian Islamic finance projects dynamics, 2010–2019.

Source: the author's assessment and the poll results.



Fig. 5. Islamic finance assets growth in Russia, 2010–2019 mln RUR.

Source: the author's calculations based on the expert analysis of the market and data provided by the market players.

the market grew with an average rate of 40% annually between 2010 and 2013, and reached 670 million rubles (12 million USD), by the end of 2014. In 2017 the growth rate exceeded 70% and in 2018 amounted to 115%. Such high growth rates, first of all, are due to the low base effect.

There is no official data on the Russian Islamic finance market size on Refinitiv (financial and risk arm of Thomson Reuters), one of the main providers of information on financial markets, including Islamic finance. According to the Global Islamic Economy Indicator, the Islamic finance assets in 2018 amounted to 38 million USD in Kyrgyzstan, and 98 million USD in Kazakhstan (Zawya, 2019). However, it should be stated that the size of the Islamic finance market in Russia is higher than in neighboring Kyrgyzstan, although the country has been introducing special regulation for the industry since 2008.

#### 4.3. Regulatory framework

Some researchers regard the lack of proper regulation as the main obstacle for the market development (Aleshin & Radchenko, 2018; Hazzar et al., 2018). Chokaev qualifies potential proper infrastructure creation as a *liberalization* of the Islamic finance industry in Russia (Chokaev, 2015). Hazzar et al. claim that there is a need “to intensify the methods of harmonizing the norms of banking operations and transactions in the integration processes of forming a single banking market”. At the early stage, they suggest, a limited range of legislative amendments is sufficient (Hazzar et al., 2018, P. 134–135).

Since its inception, the Islamic finance industry in Russia continues its development within the general Russian legislation, while not being specifically controlled by a certain regulator. The main fully-fledged Islamic finance institutions are organized as limited partnerships, non-financial entities, are not subject to licensing, and are governed by the Russian Civil Code. As an example, Amal Finance House is established in the form of a consumer society, and LaRiba-Finance company acts as a limited partnership.

Banks introducing Islamic finance products either do it directly, in the form of banking products (payment cards, interest-free credit cards, etc.), or in the form of *tawarruq*, using precious metals as commodities. In some cases, banks organize Islamic finance products through a subsidiary company, as banks cannot do *murabaha* financing directly due to the prohibition of trade operations by law. Any asset obtained by a bank should be shown in its balance sheet. In the case of Ellipse Bank, its Islamic finance branch performed several *ijarah* transactions for cars, but if the number of deals increased, the regulator would most likely raise questions about the number of cars on the bank's balance. As indicated by Juravliov (2013b), such activities could result in higher reserves requirements. Banks are also not allowed to attract investment on deposit accounts due to the interest-based system of deposits (Table 4) and controversy between risk-sharing principle and the guaranteed nature of bank deposits.

Notwithstanding some legislative initiatives in 2015, targeting selective changes into the legislation in order to remove impediments for Islamic finance contracts, none of them had passed the first reading. In 2015, the Central bank of Russia established a

**Table 4**  
Main hurdles in Islamic finance market development in Russia (from the legal side).  
Source: made by the author based on the poll results and other analytical data.

No	Obstacles	Affected market players	Description	Possible/implemented solution
1	Trade operations are prohibited	Banking institutions	Banks are not allowed to trade in goods	Only tawarruq operations are possible through commodity certificates (metals)
2	The raised funds cannot be used for investing in companies	Banking institutions	Banks are not allowed to place deposit funds as a share in the capital of companies (Chokhaev, 2015)	a) Operating through a subsidiary company
3	Limited opportunities to attract funds from the public (non-qualified investors)	Finance and investment companies (asset management companies), LLCs	Options to attract funds from the public on the basis of risk-sharing are limited	b) Special license (potentially)
4	Unfriendly tax regime: a) In all trade finance operations the VAT leads to a higher cost of financing; b) the tax is paid by the financier in <i>murabaha</i> in advance, though the payments from the clients to be received in installments; c) in <i>mudaraba</i> -based investment the clients are subject to higher income tax than the banks' depositors	All companies	The <i>murabaha</i> finance contracts are becoming much more costly compared to conventional finance operations The Islamic investors are paying higher taxes compared to banks' depositors <sup>a</sup>	Investment loans mechanism is used with the rate linked to the profitability, in some cases, accomplished by the accord and satisfaction agreement The markup in <i>murabaha</i> can be treated as the interest by the analogy with the trade credit
5	Excluded from the state support programs provided for the conventional loans users	All companies potentially subject to state subsidies	In mortgage finance and other types of finance Islamic finance institutions' clients are not subject to the programs of state support as those programs are only provided in the form of interest rate compensation.	No decision implemented yet
6	Any loans are subject to interest and penalty clauses as per the Civil Code (art. 395)	All companies	Banks and other legal entities are not allowed to provide interest-free loans without stipulating the interest rate and penalty clause. Even if such is not stipulated the court can impose it in case of a dispute.	No decision implemented yet
7	Lack of the mediation or arbitration system based on the Shariah principles for the market players	All companies	Mediation and arbitrage system are a sound alternative (which is supported by AAOIFI Shariah standards) to the customary courts in the financial dispute cases	To create arbitration courts within the non-commercial institutions (business associations, etc.)

<sup>a</sup> On March 25, 2020, in the context of state measures against the consequences of coronavirus, the President of Russia in his address speech announced that the bank depositors having amounts placed in banks and bonds exceeding 1 million RUR, will be also subject to 13% income tax.

Working group on partnership banking.<sup>12</sup> The next year, it signed an MoU with the Islamic Development Bank.<sup>13</sup> In 2017, Sberbank announced the bank's intention to propose regulatory changes (Vizcaino, 2017). In 2018, the bank suggested creating a regulatory sandbox for Islamic finance. However, until 2020, the CB of Russia has not disclosed a model for the industry development. The regulator overruns a conservative position that the market should try to operate within existing legislation. The Chairman of the Working group, Alexey Simanovsky, maintains that the existing legislation in Russia allows the market players to perform Islamic finance operations (Alev, 2017). According to his opinion, based on the poll conducted by the Central Bank, the level of demand for Islamic financial services is relatively low. At the same time, the main obstacles related to higher taxation compared to conventional operations (see Section 4.5), are within the authority of the Russian Ministry of Finance.

AAOIFI Shariah standards which were officially translated into the Russian language and launched in 2017, including a presentation in the Russian Central bank's Working group on partnership banking,<sup>14</sup> have become a reference point for the market.

The need for special regulation for the Islamic finance market has been stated in some research. It is claimed that Islamic finance operations are more complicated compared to conventional ones, the market risk is higher, and there is a need for a different approach to protect consumer rights, therefore specific regulation should be in place (Aleshin & Radchenko, 2018). In our opinion, a specific regulation for Islamic finance could be a good driving force for certain segments of the market, such as banking and *sukuk*. But the Islamic finance deals are not necessarily more complicated if the nature of the deals is taken into account. The market risk in certain operations, such as *murabaha* (the most popular Islamic financial product), is, on the contrary, mitigated at both macro and micro levels due to the fact that financing is always based on real assets.

The ongoing discussion in Russia regarding the shifting of the general regulation system from institution-based to product-based model, due to the development of fintech, may open new opportunities for the Islamic finance market at large. The transformations in the financial and banking sector of the Russian economy had been depicted by the Chairman of the Central Bank of Russia, Elvira Nabiullina, in her speech at the XXVII International Finance Congress, in July 2019. Stresing that Russia ranks third in financial inclusion rate, and this is supported by certain infrastructure, such as Faster Payment System, Marketplace etc. This transformation brings a challenge to the regulator: how to regulate and control the platforms which provide a range of services, including financial ones, since new players enter the financial market. The main issue is the approach to the regulation of "market players selling simultaneously products of various types: banking, insurance, investment, sometimes medical, and non-financial services?"<sup>15</sup> Nabiullina suggested to "move towards regulation based on types of activities, and not based on the requirements to the legal entity", as it is presently.

#### 4.4. Range of Islamic finance and investment products

In total, the Russian Islamic finance market provides both investment opportunities (through *mudaraba*-based agreements implemented in the form of investment loans, or mutual investment funds) and financing opportunities.

On the financing side, the Islamic finance and investment companies in Russia are, in fact, specializing exclusively (in case of LaRiba Finance and Fincity) or mainly (in case of Sberbank, Amal FH, and Zayed Fund) in trade finance. The key assets are grain, electronics, furniture, home and industrial equipment, and cars. The services are rendered both for individuals and enterprises (some companies specialise only in one of the segments - retail or businesses). In 2019, LaRiba Finance launched an online *murabaha* scheme.<sup>16</sup> *Musharaka* and *mudaraba*-based financing are also available. Amal Finance House and LaRiba Finance provide the latter only to highly trusted clients with a good history of cooperation. Sberbank's first, and the only known *mudaraba*-based financing, was the transaction with ELC. The bank provided target financing to certain ELC deals. Profit and loss distribution on various transaction stages came to be a challenge (Musaev & Magomedova, 2018). ELC and Amal Finance House provide leasing operations.

In 2018–2019, the market saw a rise in the initiatives for home financing. Actually, in modern Russian history, Adalet Jabiev, the founder and CEO of Badr Forte Bank, was the first comer to start Islamic mortgage financing through a cooperative scheme. He started *Menzil Cooperative* less than a year before the Bank's license was withdrawn in 2006. Among companies which started rendering home finance services in 2018, are Housing Cooperative *Zhilishchnye Traditsii* and Ak Bars Bank. Several years back, between 2015 and 2017, Amal Finance House practiced mortgage finance through *murabaha* for clients in Tatarstan and Moscow, but due to the high cost of funds and limited terms of finance (up to 3 years), the product did not enjoy high demand. The cooperative *Zhilishchnye Traditsii* uses the *diminishing musharaka* scheme, whereas the cooperative and a client buy a flat on a partnership basis and the client buys out the cooperatives part of the flat through periodic payments based on the market price. The services are available on the territory of the republics of Tatarstan, Bashkortostan, and Saint Petersburg (Table 1). Ak Bars Bank provides home

<sup>12</sup> CB sozdal rabochuyu gruppu dlya razvitiya v Rossii islamskogo bankinga (CB has created a working group for the development of Islamic banking in Russia). 07.10.2015 (updated 02.03.2020) / RIA Novosti. URL: <https://ria.ru/20151007/1298358599.html>. Access Date: April 06, 2020.

<sup>13</sup> Bank Rossii. Godovoi otchet 2016 (Bank of Russia. The annual report 2016). P. 150. URL: [http://www.cbr.ru/collection/collection/file/7797/ar\\_2016.pdf](http://www.cbr.ru/collection/collection/file/7797/ar_2016.pdf)

<sup>14</sup> At its Headquarters in Moscow, Central Bank of Russia Hosted Launch Ceremony for Russian Translation of AAOIFI's Shariah Standards / AAOIFI. May 2017. URL: <https://aaoifi.com/announcement/at-its-headquarters-in-moscow-central-bank-of-russia-hosted-launch-ceremony-for-russian-translation-of-aaoifis-shariah-standards/?lang=en>; Experti RAEIF prinyali uchastie v rabote po perevodu shariatskih standartov AAOIFI na russkiy yazyk (RAEIF experts took part in the project for AAOIFI Shariah standards translation into Russian) / Russian Association of Experts in Islamic finance. May 31, 2017. URL: <http://www.raeif.ru/onevs/36/>

<sup>15</sup> Nabiullina (2019). URL: <http://www.cbr.ru/press/event/?id=2735>

<sup>16</sup> The information provided during the poll conducted by the author.



financing for Kazan citizens via a *murabaha* scheme, whereas the bank, via its subsidiary, buys a flat and sells it to a client with a margin, and clients pay the amount in installments.

Microcredit company Barakat is the only one on the Russian market that provides interest-free loans based on the *qard hasan* principle (till August 2019, there was an option to get *qard hasan* loan through Sovcombank's social project *halva halal card*). Barakat is functioning on the territory of Chechnya and some neighboring regions. The minimum loan amount is 20,000 RUR / 313.5 USD. The maximum loan amounts to 100,000 RUR/1567.7 USD (BarakatFund, 2019). The loan term is between 6 and 18 months. The loans are granted for a limited range of purposes, such as housing, medical services, improvements, household farming, purchase of transport, and education. The fee submitted by a borrower is 800–2400 RUR / 12.5–37.6 USD (BarakatFund, 2019).

Clients, interested in Shariah-compliant investments on the Russian market, can place their funds on a *mudaraba* basis, into various fully-fledged Islamic finance companies (in some cases there are limitations for the investors range on the geographical basis). The expected income rate is between 4 and 15% p.a. depending on the region and investment scheme; and they can also invest in a mutual fund. As mentioned in Section 4.1.5, some conventional asset management companies also provide their Muslim clients with Shariah-compliant private investment schemes, mainly through following the Shariah screening criteria adopted on the international market. The Russian market witnesses a growing demand among Muslims for Shariah-compliant investment in foreign markets.<sup>17</sup> This trend is supported by the emergence of popular apps for Muslims enabling to screen stocks online according to Shariah screening methodology. Certain US Islamic asset management companies are also targeting the Russian market to attract funds and manage it in a Shariah-compliant way.

The Islamic finance operators in Russia have a geographical presence predominantly in the region, or the federal district of their main office location (Fig. 6). On the financing side, the following products are available in Russia, by region. In Tatarstan, businessmen can obtain *murabaha* and *ijarah* financing; limited clients can use project finance (*mudaraba* financing); retail customers have access to *murabaha* financing for a wide range of goods, cars and flats, and can also buy houses via the *diminishing musharaka* scheme. In Bashkortostan, the range of services is almost similar to neighbouring Tatarstan. In Dagestan, businessmen can obtain *murabaha* financing and in some cases, project finance; retail customers have access to *murabaha* financing for a wide range of goods including cars and housing equipment. In Chechnya, businessmen can obtain *murabaha* financing, and in some cases, financing based on the *diminishing musharaka* scheme; retail customers have access to *murabaha* and *ijarah* financing for a limited range of goods, and also *qard hasan* financing for limited range of purposes.

The key regions where Islamic finance services are available are, therefore, Tatarstan, Bashkortostan, Dagestan, and Chechnya.

Generally, there is no acute shortage of funds among Islamic finance companies. However, nearly a third of companies encounter the hurdle of fund deficit on a regular basis, and another third experienced this problem sporadically (Fig. 7a). On the projects side, almost 60% of Islamic finance projects in Russia have no project deficit. Twenty five percent encounter project deficits (Fig. 7b). Generally, the market is ready for the increase in Islamic finance portfolio and an allocation of bigger amounts of investment. For example, Amal Finance House alone can distribute about 1 billion RUR (about 15.7 million USD) among its clients annually (MuslimEco, 2019b).

The market lacks *takaful*, or Islamic insurance products, and this factor imposes certain limits on the market players' operations and tightens market growth. 83% of the respondents from among the Islamic finance service providers have claimed that a lack of Islamic insurance products has a negative or close to negative effect (Fig. 7c).

Due to legal (various scope of financing and business models), geographical (since the market players are dispersed and concentrate mainly on the local markets), and other factors, the existing Islamic finance market players have not worked out any liquidity management tools. The liquidity management issue is an acute problem for the microfinance companies which from time to time encounter situations when clients have to wait for financing for several months. And these periods are followed by others, when there is fund surplus and lack of reliable projects to finance. Seventy five percent of the poll participants consider that the lack of liquidity management instruments has a negative impact on their business.<sup>18</sup>

Russian banks have some experience in *tawarruq* (or *commodity murabaha* deals) and LC confirmation for Islamic deals. The first comer, Ak Bars Bank, made two *tawarruq* deals amounting to 60 and 100 million USD, in 2011 and 2014. In 2019, Sberbank participated as a confirming bank in a deal in Turkmenistan. The IDB Group was involved in all three transactions.

#### 4.5. The Main legal and tax hurdles in Islamic finance operations

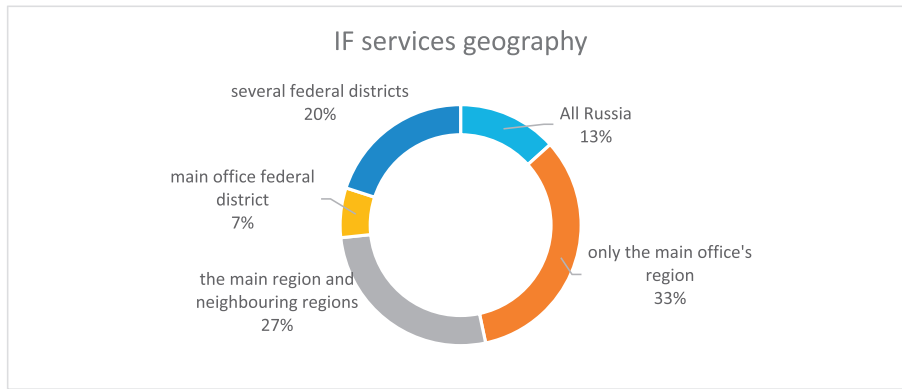
The Russian Islamic finance expert community has been discussing the potential and most efficient model of the Islamic finance market in Russia from the regulatory perspective for over ten years (Chokaev, 2015; Kalimullina, 2018). It is absolutely clear that a market addressing various target users of financing and investment mechanisms cannot develop only in a single particular form of a licensed institution. Banking institutions, microfinance companies, investment funds, insurance companies, etc. (Table 1) – the Islamic finance infrastructure is diverse and this is confirmed by international experience.

There are claims that any Shariah-compliant bank services are strictly prohibited by Federal Law on banks and banking activities

<sup>17</sup> This is also confirmed by certain consulting companies assisting Muslim investors to fund Shariah-compliant stocks abroad. See, for example: Savyonok, V. Investory vspomnili zakonah Shariata (Investors mind the Shariah law). February 16, 2017 / Vedomosti. URL: <https://www.vedomosti.ru/finance/blogs/2017/02/16/678042-investori-vspomnili-shariata>

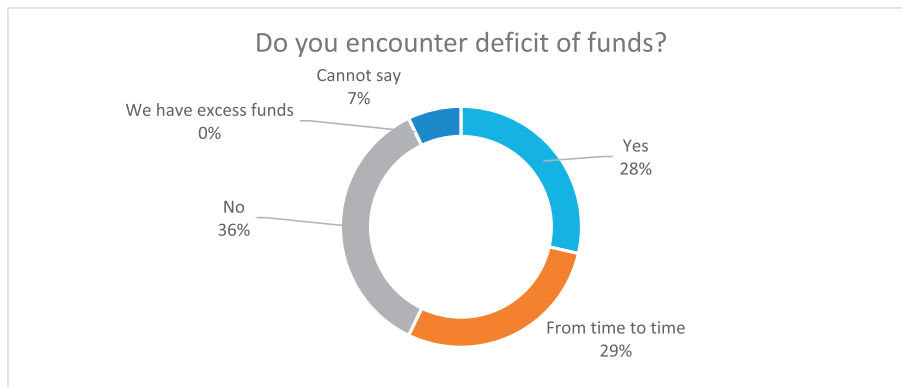
<sup>18</sup> According to the poll results.





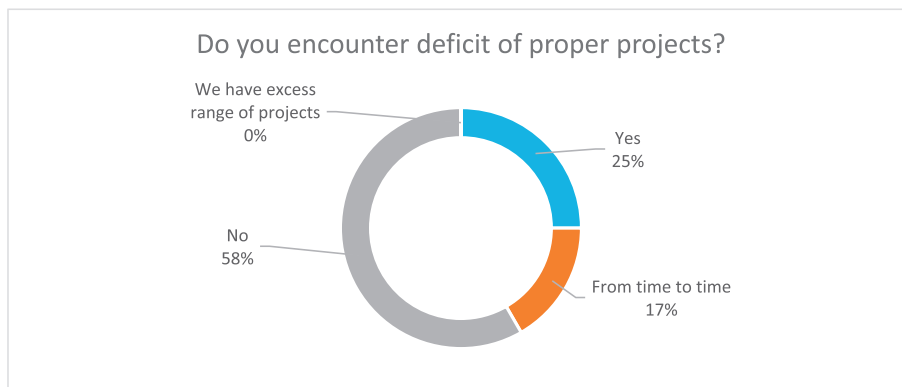
**Fig. 6.** Islamic finance projects geographic presence, 2019, %.

Source: the results of the poll conducted by the author.



**Fig. 7a.** Cases of fund deficit in Islamic finance companies, 2019, %.

Source: the results of the poll conducted by the author.

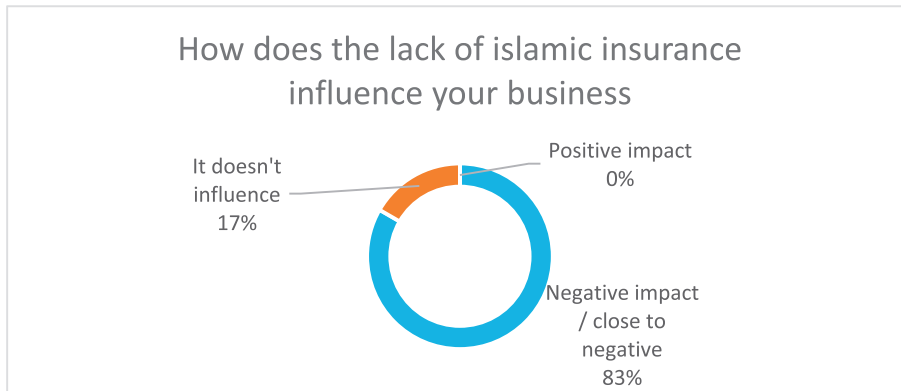


**Fig. 7b.** Cases of fund deficit in Islamic finance companies, 2019, %.

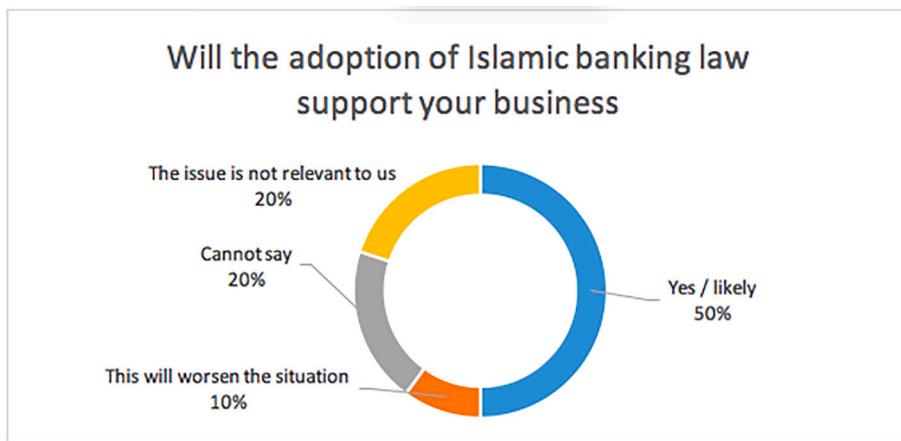
Source: the results of the poll conducted by the author.

(Yordanova, 2018). In fact, there is no law or act that prohibits directly, performing financial deals according to Shariah principles. The regulator maintains the position that the Islamic finance industry can develop within current legislation, and to a certain extent this is true (see Section 4.3). The market is growing, and figures and diagrams provided in Section 4.2 are supporting this assumption.

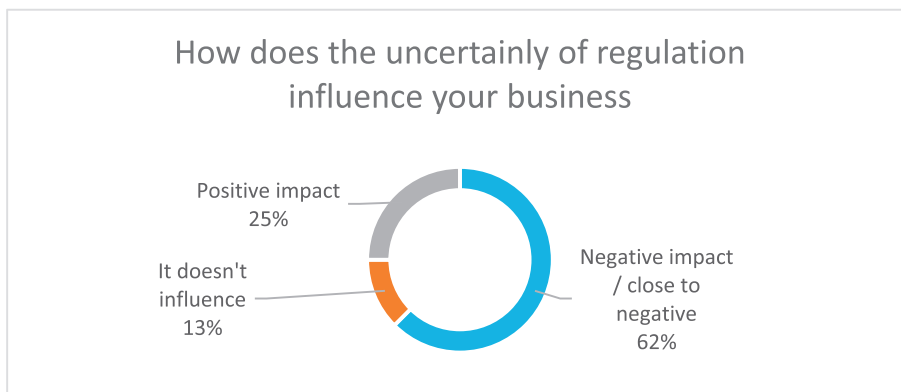
However, the hurdles still exist and this is one of the reasons why the market is underdeveloped. The main legal obstacles are generally common to other countries as well. They include the restrictions of the banking legislation, tax issues, and the Civil Code regulation related to loans (Table 4). The challenges related to the absence of regulation and unfriendly tax regimes are outlined in the research pertaining to the field of Islamic finance development in Russia (Musaev & Magomedova, 2018; Aleshin & Radchenko,



**Fig. 7c.** The demand for Islamic insurance by the market players.  
Source: the results of the poll conducted by the author.



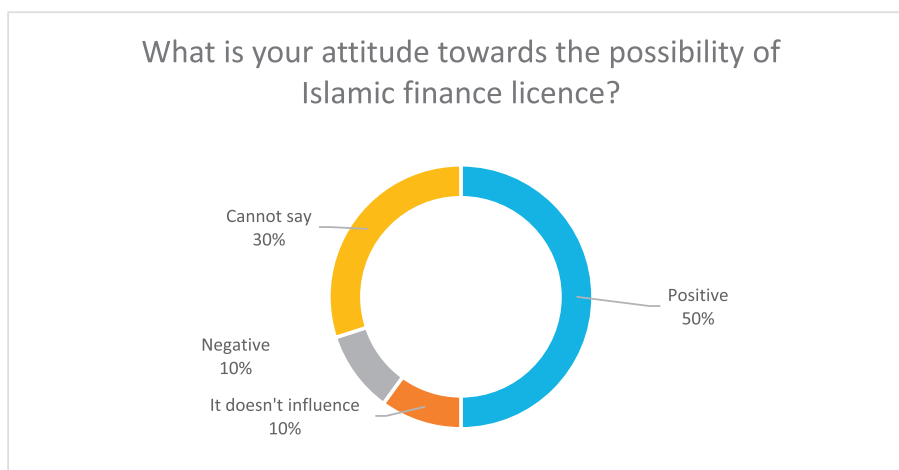
**Fig. 8a.** The anticipation of the Islamic finance market regarding the possibility of Islamic banking law.  
Source: the results of the poll conducted by the author.



**Fig. 8b.** The impact of the lack of regulation on the Islamic finance business in Russia.  
Source: the results of the poll conducted by the author.

2018 and others).

At the same time, the lack of regulation and the absence of specialized licensing, although a logical obstacle, does not prevent the market from development and, in some cases, is not regarded by the market players as adverse for the industry development. Only 50% of the poll participants consider that there is a necessity to have an Islamic banking law in Russia (Figs. 8a, 8b, 8c). Twenty percent of the Islamic finance institutions (non-banking institutions) claim that such a law will not influence their operations. Ten



**Fig. 8c.** The anticipation of the Islamic finance market regarding the special license for an Islamic finance company. Source: the results of the poll conducted by the author.

percent consider that such a law would impede market development. Such a position could be explained by the fact that not all companies are confident in the positive effect of the regulation as such. Sometimes it imposes restrictions that are very hard to follow and the process may require several years to develop a proper regulation system. Thirty percent of the poll participants are not sure how the specialized license would influence their businesses.

The current legal and tax impediments for Islamic finance industry development in Russia are provided in Table 4. Certain impediments are relevant to banks only (such as the prohibition of trade operation and limits to fund management, № 1 and № 2), the rest involve other legal entities as well.

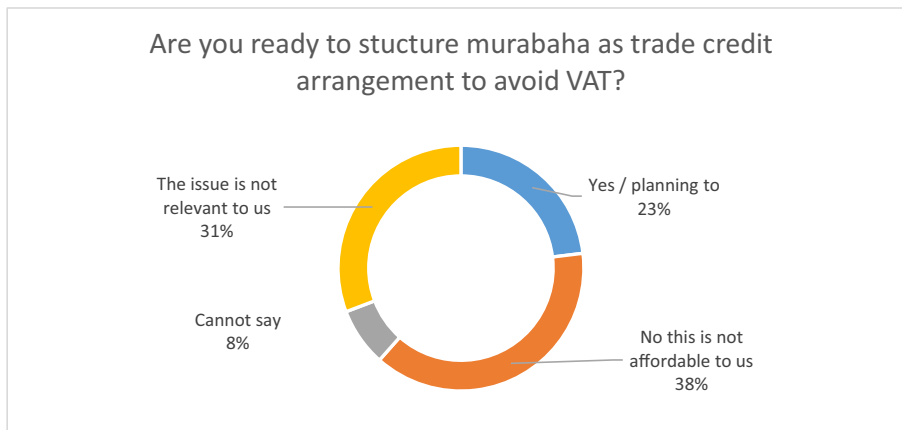
The main tax issue for Islamic finance products is taxation in a *murabaha* operation: any trading operation with real assets is subject to VAT: Islamic finance companies are obliged to pay VAT on the margin in *murabaha*. This makes the cost of *murabaha* financing higher compared to conventional finance: the bank loans are not subject to VAT. Moreover, the tax should be paid at the moment when the *murabaha* agreement is signed (Table 4). This places a higher financial burden on Islamic finance companies, especially given the fact that there is no 100% guarantee of payment in *murabaha*. Additionally, the taxation of the investors of Islamic finance companies is higher than that of bank depositors.<sup>19</sup> The unfriendly tax regime for *murabaha* is a burden for almost all market players. The taxation inequality for Islamic finance institutions in Russia is stated in numerous research (Aleshin & Radchenko, 2018; Chokaev, 2015; Hazzar et al., 2018). The decision, as advised by some market participants, like Renat Yedikhanov, the CFO of Amal Finance House and member of the Russian Central Bank's working group on partnership banking, is to structure the deals by analogy to the trade credit agreement. This agreement is not subject to VAT, according to the summary of the Russian Courts rulings, confirmed by the Ministry of Finance of Russia. However, not all market players are ready to use this opportunity to structure *murabaha*-based deals. Direct legal recognition of the *murabaha* deal is a preferred option, as it has been the case in other countries that introduced Islamic finance (Fig. 9).

Apart from VAT in *murabaha*, there are some other cases of unfriendly tax regime relevant for the investors. Unlike bank depositors, the Islamic finance clients are liable to 13% income tax independently of the income rate, whereas bank depositors are only paying income tax if the interest exceeds a certain level, according to the Russian Tax Code, article 214.2 (Tax Code of the Russian Federation (Налоговый Кодекс Российской Федерации), 1998). As per December 25, 2019, this level equaled 11.25% in rubles (key rate + 5%) and 9% in foreign currency. This factor is also depicted in some articles by Russian researchers (Aleshin & Radchenko, 2018; Bekkin & Aliskerov, 2017). According to a recent act, passed in March, 2020, since 2021 the depositors having totally over 1 million RUR (around 13,500 USD) in bank deposits will also be liable to 13% income tax, yet there will be an opportunity for a certain tax deduction.<sup>20</sup>

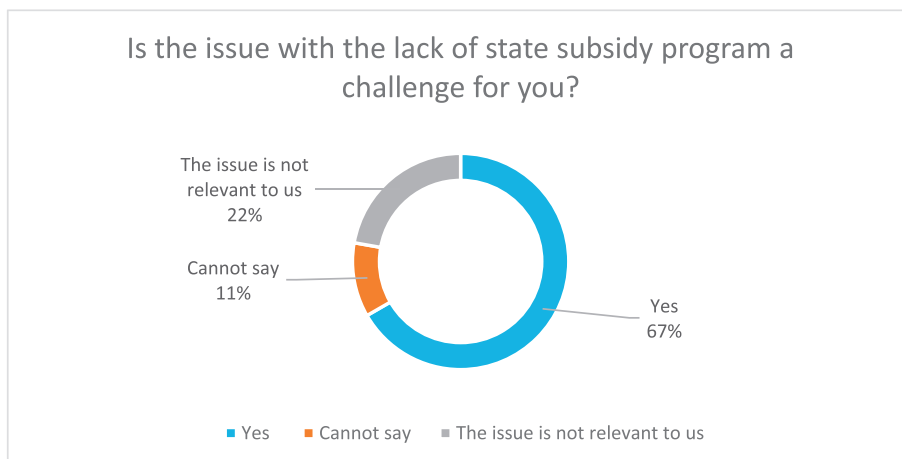
The impossibility of participation in various programs of state support (Table 4, № 5) is crucial for all Islamic finance companies (Fig. 10). It is particularly relevant to leasing businesses and mortgage financing. In Russia, the cost of mortgage financing is very high, and many bank clients, especially young families and families with two and more children, actively make use of the subsidy programs for the interest rates and maternity capital. The latter has a limited range of implementation, according to the Federal Law No 256-FZ dated 29.12.2006 "On the additional measures of the state support to the families with children", articles 7, 10. According to OECD, the average Russian citizen has only 0.9 room per person (about 25 sq.m.), which is twice less than the average European

<sup>19</sup> For more details on taxation issues, see, for example, Bekkin and Aliskerov (2017), Chokaev (2015).

<sup>20</sup> Zamahina, T. Gosduma prinjala zakon o naloge na procenty po vkladam svyshe 1 million rubley (The Parliament adopted a bill on the taxes for the interest on deposits over 1 million RUR). 31.03.2020 / Rossiyskaya Gazeta. URL: <https://rg.ru/2020/03/31/gosduma-prinjala-zakon-o-naloge-na-procenty-po-vkladam-svyshe-1-mln-rublej.html>



**Fig. 9.** The Islamic finance market players' attitude towards the opportunity to structure *murabaha* agreement as trade credit. Source: the results of the poll conducted by the author.



**Fig. 10.** The lack of state subsidy programs for Islamic finance companies (poll results). Source: the results of the poll conducted by the author.

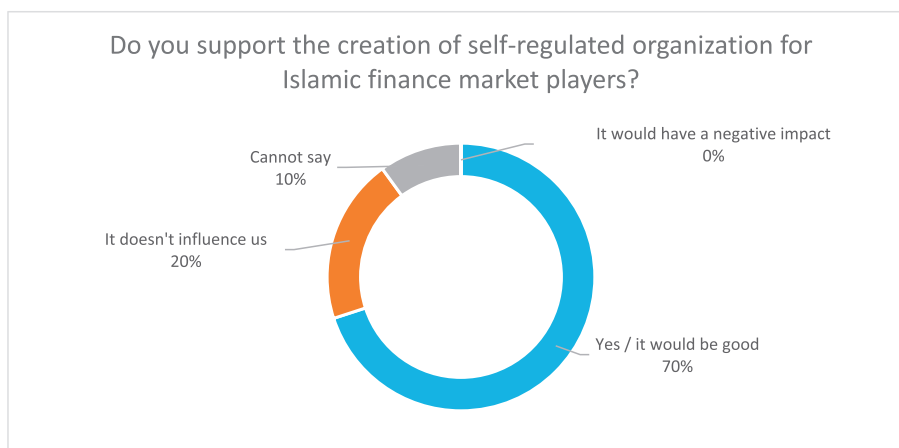
indicator (OECD, 2019).

As it can be observed, and this is confirmed by other researchers (Hazzar et al., 2018; Bekkin & Aliskerov, 2017, and others) the main issues arise with *murabaha* transaction. There is also a study confirming the absence of a crucial difference between *ijarah* and conventional leasing from the regulative and legislative points of view (Ivanova et al., 2018).

Apart from the issues described in Table 4, there are other obstacles related to the market development, among which are the lack of understanding and trust among the potential clients; the lack of cooperation among market players with regards to the Shariah issues, product development, software, etc.; the absence of liquidity management mechanisms; lack of relevant infrastructure, etc. The author suggests that uniting efforts through the creation of a self-regulatory organization (SRO)<sup>21</sup> or a market players' association could be a sound solution for the nearby future. Seventy percent of the poll participants have a positive attitude towards such an undertaking (Fig. 11). A SRO could be established by the market participants with the aim of adopting internal standards related to Shariah governance, audit, and ethics, to protect the market from disreputable players.<sup>22</sup> AAOIFI standards could be the basis of such. AAOIFI Shariah standards are translated into Russian, and auditing and accounting standards are being translated. The potential CIPA examination centre creation in Russia, on the basis of Higher School of Economics, could be positive developments in this regard (AAOIFI, 2019). A SRO could also promote education and training on Islamic finance within its members. However, there are some constraints related to SRO. The Islamic finance market is represented by a limited range of companies which have different business

<sup>21</sup> A self-regulatory organization is a non-governmental organization uniting participants representing the industry in order to protect the industry through establishing certain standards and controlling its implementation.

<sup>22</sup> In July 2019, Russian CB's governor maintain that is it high time for the development of an SRO for the Russian banking sector (See Nabiullina, 2019).



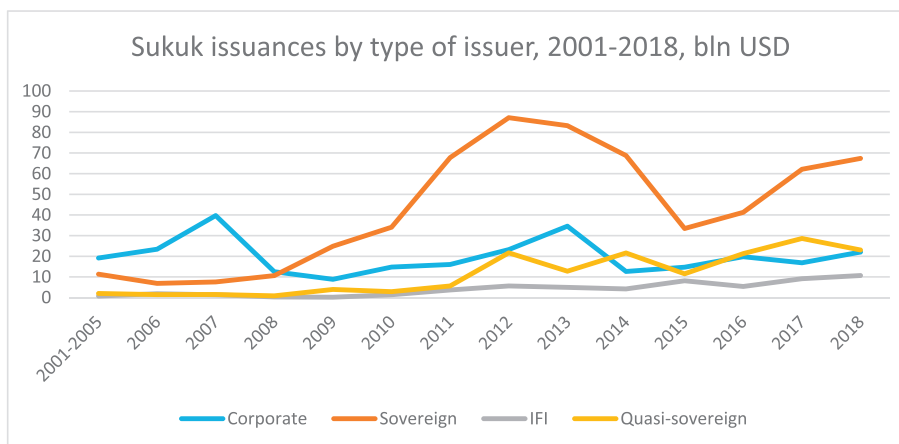
**Fig. 11.** The anticipation of the Islamic finance market regarding the possibility of Self-regulatory organization creation.  
Source: the results of the poll conducted by the author.

models and scale. Moreover, it is only partly presented by companies which are subject to financial authorities's supervision. Unlike SROs for general market participants, SROs for financial markets participants are governed by a separate law. Therefore, most likely, it would be difficult to unite all Islamic finance market players under a single SRO. Therefore other models of associations should be also considered. However, the Governor of the Russian CB admitted that there is a way to provide banking associations with the functions of SROs (Nabiullina, 2019). An association could also be a sound platform for establishing proper professional mediation and arbitration systems (Table 4, № 7) designed to achieve Islamic finance market objectives. It could also work on the issue of the lack of liquidity management tools and takaful funds through developing mechanisms and adoption standards for its implementation.

#### 4.6. Potential of the sukuk market development

*Sukuk* is among the Islamic finance instruments which are actively growing in the world but have not been practiced in Russia (Fig. 12). There were several announcements of the plans to issue *sukuk*, particularly, by the VTB Capital in 2009, company Safinat in 2010, and the Republic of Tatarstan in 2011 and 2013. However, the plans did not come true. In 2017, the pilot *sukuk mudaraba* issuance was made at Moscow Stock Exchange (*Mosbirzha*). In fact, it was a technical issue by SPV Sukuk Invest LLC, in the symbolic amount of 1 million RUR / 15,700 USD and the term of 2 months, aimed at demonstrating to the market and the Central Bank that *sukuk* is practically possible in Russia. The structure was approved by the Shariah expert Bulat Mulyukov, and supported by the Russian Association of Experts in Islamic Finance. All proceeds were invested into the Amal Finance House based on *mudaraba* agreement.

In 2019, a new initiative was announced by the Higher School of Economics, Moscow. The Project Agrofinmost was developed by the HSE-Skolkovo Institute for Law and Development in the framework of the President's Decree to raise Russian agricultural exports. The project team considers *sukuk* as one of the potential options to reach this aim. Since the main importers of the Russian grains,



**Fig. 12.** Sukuk market dynamics, world, 2001–2018.  
Source: made by the author based on IIFM data (IIFM, 2019).

particularly wheat, are Muslim countries, *sukuk* could be the sound instrument to attract investment into the agricultural sector and raise the amount of produce and export of grains, and to enhance food security in the importing countries (Ivanov et al., 2019). In November 2019, the idea was presented within a special session at AAOIFI-World Bank Conference in Bahrain (AAOIFI, 2019).

#### 4.7. The local Shariah background

Although the Shariah aspects of the market are not the subject of the present article, it is worth sharing some important observations about some internal specifics of the market with regards to the Shariah regulation. Although Russia has seen an interruption of the natural continuance of its religions traditions in 1917–1990, the Russian Muslim community, in the recent decades, has succeeded in maintaining and developing expertise in *fiqh muamalat al malia*, based on the traditional Islamic schools of thought (*mazhabs*), the main centres of which are in Kazan (the capital of Tatarstan) and Makhachkala, the capital of Dagestan. This means that Islamic finance projects in Russia are not that dependent on the international expert community, unlike Kazakhstan and Kyrgyzstan, which often invited international Shariah experts to the Shariah boards of Islamic Banks. In certain matters, the Russian Shariah experts follow a stricter line than suggested in the AAOIFI Shariah standards. Juravliov (2013a), the researcher of Islamic finance and banking issues, outlines the "scrupulous implementation of both the spirit and the letter of Shariah precepts" in contracts. Particularly, in Amal Finance House and LaRiba Finance company, there is a difference in their attitude to *wakala* in the context of *murabaha*. Unlike the common practice in international market, the companies do not appoint the client as an agent and "perform itself all the aspects of a sale"<sup>23</sup>. The companies do not practice fines and penalties for a delay or default on payment, although it is allowed by AAOIFI for charity purposes. It should be noted that this is relevant not only for the two companies mentioned, but also for some other market players. A stricter approach is also implemented with regards to *qabd* (possession): the Shariah committees make sure that the institution acquires the assets physically through a personal inspection in as many cases as possible.

#### 4.8. Forecast

The existing regulatory constraints and unfriendly tax regime are not likely to change in the coming 3–5 years. There are no signs that regulatory authorities are planning to introduce any special regulation for the small but promising market. At the same time, chances are that the authorities will not impose any impediments for the market development, thus allowing the pilot projects to start and grow. It is of common practice in the Russian history of legislative initiatives that the market is first afforded an opportunity to develop without special regulation, and once the market approaches the tipping point, the regulation is adopted. Examples are the microfinance market and leasing.

At the same time, it is clear that Islamic finance operations would not be regulated as such. Each of the key products would be subsumed under a certain existing contract within the Russian Civil Code and treated based on the nature of the deals subject to the Russian law, unlike the situation in Kazakhstan, Tajikistan or Kyrgyzstan, the CIS countries which adopted special laws on Islamic banking and finance. (The National Bank of Tajikistan has even approved a separate book of accounts for Islamic finance based on AAOIFI accounting standards). It means that the Islamic finance market players in Russia may be forced to bear the costs of running two accounting procedures in parallel, in order to comply both with the requirements of the law and market at large and to be able to fulfil the requirements of internal ethical standards and be transparent to their stakeholders. At the same time, some chances appear within the framework of the Eurasian Economic Union: it is planned to harmonize the financial regulations of the member countries by 2025.

In case no significant changes are introduced, and no shocks affect the economy, the market is likely to grow by moderate amounts of 3–4 bln rubles / 47–78 million USD annually. This is explained by several factors. Among them are general upward trend on the market, growing (although, slowly) interest from among Russian Muslims to abide by Shariah in their financial affairs, and start and continuance of the Islamic financial deals by Sberbank, Zayed Fund, and housing cooperatives. Successful *sukuk* issuances and new investment initiatives with the participation of foreign Islamic investors in Russia could bring to the market another 1 bln USD annually at least. Lack of regulatory, institutional, and infrastructure support for the Islamic finance market in Russia can result in a growing amount of investment into foreign stock markets, as fintech development made it much easier and more comfortable for the Russian Muslim investors to invest into foreign Islamic stocks through mobile phones.

### 5. Concluding remarks

From about 30+ Islamic finance project initiatives launched in Russia in the period 2010–2018, about twenty projects are active, demonstrating growth and expansion, albeit moderate. The main part of the growth throughout 2017–2019 is due to the commence of its Islamic finance operations by Sberbank, which had allocated certain limits to the partnership and trade based operations, and also due to the new projects in mortgage financing through cooperative mechanisms. All these stand for the low base effect. Sberbank's intention to create a separate partnership finance department confirms its long-lasting strategic vision of the emerging market.

The market size exceeded 5 billion RUR / 78.4 million USD by the end of 2019 and is expected to grow further by 3–4 bln rubles annually, at least. This amount does not include several *tawarruq* deals, direct investment deals, including those with the involvement

<sup>23</sup> Juravliov (2013a). P. 37.

of the foreign capital. As well, it should be noted that during the last ten years ruble depreciated by half, and in case of a more stable situation the figures in USD could have been at least twice higher. The total number of employees of the Islamic finance companies and projects is estimated at 150 people and the number of clients is estimated at about 40,000. More clients from the investment and finance sides get involved in the market year on year. The growing number of courses and events related to Islamic finance along with the continuation of the expert discussion on various platforms both in Russia and abroad will certainly contribute to the market's maturity.

The range of Islamic finance institutions and products show the wide scope of opportunities for the market: there are banking 'windows' (with limited range of operations and no special license, though), investment companies, asset managers, housing co-operatives and microfinance organizations working in the market and providing both investment opportunities and various scopes of financing: *musharaka* (including *diminishing musharaka for home financing*), *mudaraba*, *murabaha*, and *ijarah*. The product range is also diverse: there are all main types of Islamic finance instruments implemented in practice, except for *salam*, *istisna'*, Islamic insurance, and *sukuk*. *Murabaha* is by far one of the most popular Islamic finance products, which is used in almost all existing Islamic finance companies. Personal car financing is provided by 7 market players. All these provide the newcomers with the opportunities to start the operations based on the existing experience.

Nevertheless, the Islamic finance market in Russia is still not mature enough. The Islamic finance operators are geographically distorted and have very different business scopes. Hence, there is a lack of internal competition. Each company has its own policy related to the geography of financing, range of products, economic sectors to finance, and type of client. The main regions with a relatively diverse range of Islamic finance products available are Tatarstan, Dagestan, Bashkortostan, and Chechnya.

The lack of market regulation is a negative side that holds back the potential newcomers and clients, and, on the contrary, the same relative market freedom allows the existing companies to experiment and make use of the emerging niche segment. Not all the market participants are willing to be regulated by a so-called potential Islamic banking law or to work under a special license. That said, the market players are confirming the necessity of a tax-friendly regime for Islamic finance, providing mechanisms of state subsidies to the Islamic finance institutions so that the level playing field was secured. Among potential solutions that could contribute to the market development is the creation of a self-regulatory organization that could be a platform for adoption of internal standards, and any kind of market players' association to create and implement liquidity management tools, develop proper mediation and arbitration systems, and introduce *takaful* models.

The market is driven by a number of personal initiatives and its future is very much dependent on the novel projects that would cover new segments, such as *takaful*, and create fair competition to the existing market players. A number of international initiatives, led by the research institutions and think tanks, such as the Agrofinmost Project, aimed at the expansion of the Russian grain exports through Islamic finance mechanisms, could be a good driving factor for pilot projects, particularly, in the *sukuk* market. All these factors would drive the market to higher figures and financial stability. Further research could focus on certain mechanisms that have potential to facilitate Islamic finance market development for the benefit of the country's economy, and bring confidence to the local and international investors about the market and its opportunities. Whatever it be, according to Russian CB's governor, the pivotal improvement of the investment climate is the main task to grow the economy (Nabiullina, 2019).

### Declaration of competing interest

Me, the author of this article, bindingly and explicitly declare of the partial and total lack of actual or potential conflict of interest with any other third party whatsoever, which may arise as a result of the publication of this article. This statement relates to the study, data collection and interpretation, writing and preparation of the article, and the decision to submit the manuscript for publication.

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**Attachment A****Attachment A****The Poll data input form**

1. Company name
2. starting from which year your company is implementing Islamic finance projects or services?
3. Type of organization
  - banking institution
  - trustee company
  - investment company
  - asset manager (MIF)
  - insurance company
  - leasing company
  - housing cooperative
  - other

4. How do you assess the results of your activities throughout the project life cycle?

	Poor	Not enough	Sufficient	Good	Excellent	Cannot say
Client base growth						
Introduction of new products						
Geographic expansion						
Assets dynamics						
Income						

5. How do you assess the results of your activities in 2019?

	Poor	Not enough	Sufficient	Good	Excellent	Cannot say
Client base growth						
Introduction of new products						
Geographic expansion						
Assets dynamics						
Income						

6. Can you share any other results achieved in recent year?

7. Which Islamic finance products do you implement?

	We implement	Do not implement	Would like to implement, but the law does not allow to do that	At the stage of introduction
Mudaraba (funding from companies)				
Mudaraba (funding from retail clients)				
Qard hasan (funding)				
Musharaka				
Diminishing musharaka				

Mudaraba				
Murabaha (for corporate clients)				
Murabaha (for retail clients)				
Ijara (including <i>ijara muntahiya bittamleek</i> )				
Salam				
Istisna				
Tawarruq				
Qard hasan (financing)				
Sukuk				
Other (please stipulate)				

8. Which Islamic finance products do you plan to introduce in the coming 2 years?

\_\_\_\_\_

9. Do you provide export financing for the following types of products?

- ☐ Agricultural products
- ☐ Energy commodities
- ☐ Metals and chemistry
- ☐ Machines and equipment
- ☐ We do not do export financing
- ☐ It is planned
- ☐ Other \_\_\_\_\_

10. What is the geography of your presence?

- ☐ All Russia
- ☐ Only 1 region
- ☐ The main region and neighboring regions
- ☐ One Federal district
- ☐ Several federal districts
- ☐ Other \_\_\_\_\_

11. Are your services available in the following regions

	Yes	Limited range of services	Not yet, but we are planning to	no
Moscow				
Moscow region				
Saint Petersburg				
Tatarstan				
Bashkortostan				
Other regions of the Volga				
Dagestan				
Chechnya				
Other regions				

12. Please indicate the types of products that you finance

- ☐ electronics
- ☐ equipment for business
- ☐ automobiles
- ☐ houses
- ☐ commercial property
- ☐ goods for sale
- ☐ agricultural goods
- ☐ nothing mentioned
- ☐ other \_\_\_\_\_
- ☐ home equipment

13. To which extent the solution of the problems (challenges, factors) indicated in the table is relevant for you?

	Very relevant	It would be good	It will have no impact	It will worsen the situation	Cannot say
Introduction of the Islamic (partnership) banking law					
The friendly tax regime in murabaha transaction					
Creation of a special license for Islamic finance companies					
Change of the norm of the payment of interest over loans					
Availability of the state subsidy programs for Islamic finance clients					
Creation of the association (self-regulated organization) for the Islamic finance market players					
Creation of liquidity management tools					

14. To which extent the following factor influence the growth of your business?

	Negative effect	Likely negative	It has no impact	Likely positive	Positive
Uncertainty of regulation of the Islamic finance market					
The tax burden in murabaha transaction					
Lack of state subsidy mechanisms					
Lack of Islamic insurance					
Other (please, indicate)					

15. Are you ready to structure murabaha deal as a commercial credit deal for the sake of taxation?

- ☐ Yes
- ☐ No
- ☐ It is not relevant for us
- ☐ Cannot say

16. Do you encounter a lack of financial resources?

- ☐ Yes
- ☐ From time to time
- ☐ No
- ☐ We have an excess of funds
- ☐ Other

17. Do you encounter a lack of projects to place funds?

- ☐ Yes
- ☐ From time to time
- ☐ No
- ☐ We have an excess of projects
- ☐ Other

18. How many clients have used your products totally?

19. How many employees are involved in Islamic finance projects?

20. Your name

## Attachment B



Fig. A. The dynamics of the exchange rate of USD in Russian rubles in 2010–2019.

The Bank of Russia. The dynamics of foreign currency exchange rate. USD. Access date: December 15, 2019. URL: [http://www.cbr.ru/currency\\_base/dynamics/?UniDbQuery.Posted=True&UniDbQuery.mode=2&UniDbQuery.date\\_req1=&UniDbQuery.date\\_req2=&UniDbQuery.VAL\\_NM\\_RQ=R01235&UniDbQuery.FromDate=01.01.2010&UniDbQuery.ToDate=25.12.2019](http://www.cbr.ru/currency_base/dynamics/?UniDbQuery.Posted=True&UniDbQuery.mode=2&UniDbQuery.date_req1=&UniDbQuery.date_req2=&UniDbQuery.VAL_NM_RQ=R01235&UniDbQuery.FromDate=01.01.2010&UniDbQuery.ToDate=25.12.2019)

Source: The Central Bank of Russia.

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